

FORM 10-K PART IV

**THE DIAMOND STATE TELEPHONE COMPANY**  
**SCHEDULE V – PLANT, PROPERTY AND EQUIPMENT**  
**FOR THE YEAR ENDED DECEMBER 31, 1989**

(Dollars in Thousands)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions at Cost Note (a)	Retirements Note (b)	Other Changes	Balance at End of Period
Land . . . . .	\$ 2,970	\$ --	\$ --	\$ (23)	\$ 2,947
Buildings . . . . .	34,071	1,101	142	--	35,030
Central Office Equipment . . . . .	210,099	23,717	11,097	--	222,719
Telephone Instruments and Related Equipment . . . . .	14,507	1,431	397	--	15,541
Pole Lines . . . . .	7,192	578	147	--	7,623
Cable and Wiring . . . . .	242,815	13,730	2,253	--	254,292
Conduit . . . . .	34,687	1,344	131	--	35,900
Office Equipment and Furniture . . . . .	4,824	540	653	--	4,711
Vehicles and Other Work Equipment . . . . .	5,304	420	(9)	--	5,733
Other . . . . .	964	44	148	--	860
Total In Service (c) . . . . .	557,433	42,905	14,959	(23)	585,356
Plant Under Construction . . . . .	10,354	(426)	--	--	9,928
Other . . . . .	219	26	--	--	245
Total Plant, Property and Equipment . . . . .	<u>\$ 568,006</u>	<u>\$ 42,505</u>	<u>\$ 14,959</u>	<u>\$ (23)</u>	<u>\$ 595,529</u>

The notes on page F-29 are an integral part of this Schedule.

FORM 10-K PART IV

**THE DIAMOND STATE TELEPHONE COMPANY**  
**SCHEDULE VI – ACCUMULATED DEPRECIATION**  
**FOR THE YEARS ENDED DECEMBER 31, 1991, 1990 and 1989**

(Dollars in Thousands)

Column A	Column B	Column C	Column D	Column E	Column F
Classification	Balance at Beginning of Period	Additions Charged to Expenses	Retirements	Other Changes Note (a)	Balance at End of Period
Year 1991 . . . . .	\$ <u>238,718</u>	\$ <u>39,165</u>	\$ <u>16,362</u>	\$ <u>(300)</u>	\$ <u>261,221</u>
Year 1990 . . . . .	\$ <u>222,745</u>	\$ <u>34,063</u>	\$ <u>17,818</u>	\$ <u>(272)</u>	\$ <u>238,718</u>
Year 1989 . . . . .	\$ <u>206,693</u>	\$ <u>31,602</u>	\$ <u>14,811</u>	\$ <u>(739)</u>	\$ <u>222,745</u>

(a) Includes any gains or losses on disposition of plant, property, and equipment. These gains and losses are amortized to depreciation expense over the remaining service lives of remaining net investment in plant, property and equipment.

FORM 10-K PART IV

**THE DIAMOND STATE TELEPHONE COMPANY**  
**SCHEDULE X – SUPPLEMENTARY INCOME STATEMENT INFORMATION**  
**FOR THE YEARS ENDED DECEMBER 31, 1991, 1990 and 1989**

(Dollars in Thousands)

Column A	Column B
Item	Charged to Costs and Expenses
<u>Year 1991</u>	
Maintenance and repairs . . . . .	\$ <u>36,359</u>
<u>Year 1990</u>	
Maintenance and repairs . . . . .	\$ <u>38,579</u>
<u>Year 1989</u>	
Maintenance and repairs . . . . .	\$ <u>36,922</u>

Advertising costs for 1991, 1990 and 1989 are not presented as such amounts were less than 1 percent of total operating revenues.

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K

☒

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 1991

OR

☐

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from to

Commission File Number 1-7368

THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY

A New York  
Corporation

I.R.S. Employer Identification  
No. 53-0046277

1710 H Street, N.W., Washington, DC 20006

Telephone Number 202-392-1324

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Forty Year 7 3/4% Debentures, due November 1, 2013	New York Stock Exchange

THE REGISTRANT, A WHOLLY-OWNED SUBSIDIARY OF BELL ATLANTIC CORPORATION, MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION J(1) (a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION J(2).

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

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UNLESS OTHERWISE INDICATED, ALL INFORMATION IS AS OF MARCH 23, 1992

PART I

Item 1. Business

THE COMPANY

The Chesapeake and Potomac Telephone Company (the Company) is incorporated under the laws of the State of New York and has its principal offices at 1710 H St., N.W., Washington, DC (telephone number 202-392-1324). The Company is a wholly-owned subsidiary of Bell Atlantic Corporation (Bell Atlantic).

The Company presently serves a territory consisting of a single Local Access and Transport Area (LATA) which lies wholly within the District of Columbia.

The Company provides two basic types of telecommunications services. First, the Company transports telecommunications traffic between subscribers located within the same LATA (intraLATA service), including both local and toll services. Second, the Company provides exchange access service, which links a subscriber's telephone or other equipment to the transmission facilities of interexchange carriers which, in turn, provide telecommunications service between LATAs (interLATA service). (See "Line of Business Restrictions.")

OPERATIONS

The Company's lines of business comprise Local Service, Network Access, Toll Service, Directory, Billing and Other Services. Local Service includes the provision of local exchange ("dial tone"), local private line, and public telephone services (including service for both Bell Atlantic-owned and customer-provided coin telephones). Among other services provided in this category are Centrex (central office-based switched telephone service enabling the subscriber to make both intercom and outside calls) and a variety of special and custom calling services. Network Access is the provision to interexchange carriers and local exchange carriers of access to the local exchange network for switched transmissions, and provision to subscribers (including end-users) of dedicated private lines for voice and data transmissions. Toll Service includes message toll service (MTS) (calling service beyond the local calling area) within LATA boundaries, and intraLATA Wide Area Toll Service (WATS)/800 services (volume discount offerings for customers with highly concentrated demand). Directory, Billing and Other Services includes directory publishing (both Yellow Pages and White Pages), billing services for interexchange and other carriers and information service providers, and customer premises services such as inside wire installation and maintenance. The Company also provides various operator services.

The Company provides billing and collection services, including recording, rating, bill processing and bill rendering, for interexchange carriers. The largest purchaser of billing and collection services is American Telephone and Telegraph Company (AT&T). During the last several years, however, AT&T ceased its purchase of interstate WATS and private line billing and of billing inquiry services from the Company, as well as its purchase of MTS billing for a small percentage of its total customer base. By October 1991, AT&T had also ceased its purchase of rating and most recording services from the Company. The Company has also entered into arrangements to provide billing services for MCI Communications Corporation (MCI), US Sprint Communications Company (US Sprint) and certain other carriers.

The Company has been making and expects to continue to make significant construction expenditures to meet the demand for communications services and further improve such services. The total investment in plant, property and equipment increased from \$1,307 million at December 31, 1989, to \$1,374 million at December 31, 1990, and to \$1,409 million at December 31, 1991, in each case after giving effect to retirements, but before deducting accumulated depreciation at such date. Construction expenditures of the Company were \$123 million in 1990 and \$108 million in 1991 (see Item 2 - "Properties" for an analysis by component of such expenditures).

The Company is projecting construction expenditures of approximately \$104 million for 1992. Most of these funds are expected to be generated internally. Some external financing may be necessary or desirable.

#### LINE OF BUSINESS RESTRICTIONS

Prior to January 1, 1984, the Company was an associated company of the Bell System and was a wholly-owned subsidiary of AT&T. Pursuant to a court-approved divestiture (Divestiture), AT&T transferred those assets of the Bell operating companies (BOCs), including the Company, that related to exchange communications, exchange access functions and printed directory advertising to seven newly formed regional holding companies (RHCs), including Bell Atlantic.

The consent decree (Consent Decree) and the plan of reorganization (Plan), which set forth the terms of Divestiture, contained certain provisions relating to the post-Divestiture activities of the RHCs. The Consent Decree's principal restrictions on post-Divestiture activities of the RHCs included prohibitions on providing interexchange telecommunications or information services, engaging in the manufacture of telecommunications equipment and customer premises equipment (CPE)\*, or entering into any non-telecommunications businesses without Court approval. The United States District Court for the District of Columbia (Court) has retained jurisdiction over the construction, modification, implementation and enforcement of the Consent Decree.

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\*Customer premises equipment includes telephone sets and private branch exchanges (PBXs) used by a customer on the customer's premises to originate, route or receive telecommunications.

On September 10, 1987, the Court issued an opinion eliminating the prohibition on entering into any non-telecommunications business. However, the Court refused to eliminate the restrictions relating to manufacturing or providing interexchange services. With respect to information services, the Court issued an opinion on March 7, 1988 which permitted the RHCs to engage in a number of information transport functions as well as voice storage and retrieval services, including voice messaging and electronic mail offerings and certain information gateway services. The RHCs were generally prohibited, however, from providing the content of the data they transmit. As the result of an appeal by Bell Atlantic, the other RHCs and other parties of the Court's September 10, 1987 decision, the Court of Appeals ordered the Court to reconsider the RHCs' request to provide information content under a standard more favorable to the RHCs. On July 25, 1991, the Court granted that request, but imposed a stay pending appeal of that decision. On October 7, 1991, the Court of Appeals vacated the stay, permitting the RHCs to provide information services.

#### FCC REGULATION AND INTERSTATE RATES

The Company is subject to the jurisdiction of the Federal Communications Commission (FCC) with respect to interstate services and certain related matters. The FCC prescribes a uniform system of accounts for telephone companies, interstate depreciation rates and the principles and standard procedures used to separate plant investment, expenses, taxes and reserves between those applicable to interstate services under the jurisdiction of the FCC and those applicable to intrastate services under the jurisdiction of the respective state regulatory authorities (separations procedures). The FCC also prescribes procedures for allocating costs and revenues between regulated and unregulated activities.

##### Interstate Access Charges

The Company provides intraLATA service but does not participate in the provision of interLATA service except through offerings of exchange access service. The FCC has prescribed structures for exchange access tariffs to specify the charges (Access Charges) for use of the Company's facilities used or available for the origination and termination of interstate interLATA service. These charges are intended to recover the related costs of the Company which have been allocated to the interstate jurisdiction (Interstate Costs) under the FCC's separations procedures.

In general, the tariff structures prescribed by the FCC provide that Interstate Costs of the company which do not vary based on usage (non-traffic sensitive costs) are recovered from subscribers through flat monthly charges (Subscriber Line Charges), and from interexchange carriers through usage-sensitive Carrier Common Line (CCL) charges (see "FCC Access Charge Pooling Arrangements"). Traffic-sensitive Interstate Costs are recovered from carriers through variable access charges based on several factors, primarily usage.

In May 1984, the FCC authorized the implementation of Access Charge tariffs for "switched access service" (access to the local exchange network) and of Subscriber Line Charges for multiple-line business customers (up to \$6.00 per month per line). In June 1985, the FCC authorized Subscriber Line Charges for residential and single-line business customers at the rate of \$1.00 per month per line, which increased to \$2.00 effective June 1, 1986, to \$2.60 effective July 1, 1987, to \$3.20 effective December 1, 1988, and to \$3.50 on April 1, 1989. The Company is charging \$2.49 for residential and business customers.

As a result of the phasing in of Subscriber Line Charges, a substantial portion of non-traffic sensitive Interstate Costs is now recovered directly from subscribers, thereby reducing the per-minute CCL charges to interexchange carriers. The significant reduction in CCL charges has tended to reduce the incentive for interexchange carriers and their high-volume customers to bypass the Company's switched network via special access lines or alternative communications systems. (See "Competition - Bypass.")

#### FCC Access Charge Pooling Arrangements

The FCC previously required that all local exchange carriers (LECs), including the Company, pool revenues from CCL and Subscriber Line Charges which cover Interstate Costs associated with the lines from subscribers' premises to telephone company central offices, i.e., the non-traffic sensitive costs of the local exchange network. To administer such pooling arrangements, the FCC mandated the formation of the National Exchange Carrier Association, Inc. (NECA).

Some LECs received more revenue from the pool than they billed their interexchange carrier customers using the nationwide average CCL rate. Other companies, including the Company, received substantially less from the pool than the amount billed to their interexchange carrier customers.

By an Order adopted in 1987, the FCC changed its mandatory pooling requirements. These changes, which were effective April 1, 1989, permitted the Company to withdraw from the pool and to charge CCL rates which more closely reflect their non-traffic sensitive costs. The Company is still obligated to make contributions of CCL revenues to companies who choose to continue to pool non-traffic sensitive costs so that the pooling companies can charge a CCL rate no greater than the nationwide average CCL rate. In addition to this continuing obligation, the Company has a transitional support obligation to high cost companies who left the pool in 1989 and 1990. This transitional support obligation phases out over five years. These long-term and transitional support requirements will be recovered in the Company's CCL rates.

#### Depreciation

Depreciation rates provide for the recovery of the Company's investment in telephone plant, and are revised periodically to reflect more current estimates of remaining service lives and future net salvage. In January 1988, the FCC issued an Order requiring LECs such as the Company to amortize certain interstate depreciation reserve deficiencies over a five-year period, retroactive to January 1, 1987. The FCC had previously authorized the amortization of these differences by the Company over a shorter period. In August 1991, the FCC ordered the

Company to amortize the remaining balance of the reserve deficiencies over the period from July 1991 to June 30, 1992.

#### Interstate Access Rate of Return

Pursuant to rules it adopted in 1985 and 1986, the FCC prescribes the rate of return on the interstate access services of LECs such as the Company. The FCC has set an 11.25 percent return for 1991 and beyond. This rate of return serves as a benchmark for regulation of the Company under price cap regulation. (See "Price Caps.")

The FCC had also adopted rate of return enforcement rules, which required carriers to target their rates to produce the prescribed return and to refund automatically earnings in excess of their allowable return (the prescribed target return plus an increment of 25 basis points on overall earnings or 40 basis points on each of three categories of service). On January 22, 1988, the U.S. Court of Appeals for the District of Columbia Circuit held that the FCC's automatic refund rule was arbitrary and capricious, and remanded the case to the FCC so that it could, if it wished, promulgate a new refund rule. The FCC subsequently stayed indefinitely any requirement that carriers refund excess earnings for the initial enforcement period (October 1985 through December 1986), during which time the prescribed rate of return was 12.75 percent. The FCC has taken no action to revise its enforcement rules. The FCC has, however, permitted access customers to file complaints for damages in which the damages are calculated in accordance with the FCC's automatic refund methodology. Appeals of the FCC's rulings permitting such complaints to be filed were dismissed as premature. The Company has settled the major complaints.

Under FCC-approved tariffs, all of the Bell Atlantic telephone companies are charging uniform rates for interstate access services (with the exception of Subscriber Line Charges) in all Bell Atlantic jurisdictions, and are regarded as a single unit by the FCC for rate of return measurement. A supplementary agreement covers the sharing of these interstate revenues with affiliated Chesapeake and Potomac Telephone Companies (C&P Companies).

#### Price Caps

On September 19, 1990, the FCC adopted "price cap" regulation as a replacement for traditional rate of return regulations for LECs, such as the Company. The new system places a cap on overall prices for interstate services and requires that the cap decrease annually, in inflation-adjusted terms, by a fixed amount which is intended to reflect expected increases in productivity. The price cap level can also be adjusted to reflect "exogenous" changes such as changes in FCC separations or accounting rules. LECs subject to price caps have somewhat increased flexibility to change the prices of existing services within certain groupings of interstate services, known as "baskets".

Under price cap regulation, the Company can earn a rate of return on overall investment of up to 12.25% (100 basis points over the currently authorized rate of return of 11.25%). If the Company's rate of return is between 100 and 500 basis points above the authorized rate of return (that is, currently, between 12.25% and 16.25%), the Company must share 50% of the earnings above the 100-basis-point level with customers by reducing rates prospectively. All earnings

above the 500-basis-point level must be returned to customers in the form of prospective rate decreases. If, on the other hand, the Company's rate of return is more than 100 basis points below the authorized rate of return (that is, currently, below 10.25%), the Company is permitted to increase rates prospectively to make up the deficiency.

LEC price cap regulation took effect on January 1, 1991. The LEC price cap order has been appealed by several parties to the United States Court of Appeals for the District of Columbia Circuit. These appeals are being held in abeyance pending the FCC's resolution of pending petitions for reconsideration. Pending a decision on these appeals, which is unlikely to occur within the next year, price cap regulation remains in effect for the Company.

### Computer Inquiry III

In August 1985, the FCC initiated Computer Inquiry III to re-examine its regulations requiring that "enhanced services" (e.g., voice message services, electronic mail, videotext gateway, protocol conversion) be offered only through a structurally separated subsidiary. In 1986, the FCC eliminated this requirement, permitting the Company to offer enhanced services, subject to compliance with a series of nonstructural safeguards designed to promote an effectively competitive market. These safeguards include detailed cost accounting, protection of customer information and certain reporting requirements.

In June 1990, the United States Court of Appeals for the Ninth Circuit vacated and remanded the Computer Inquiry III decisions, finding that the FCC had not fully justified those decisions.

On December 20, 1991, the FCC adopted an order on remand which reinstated structural relief upon a company's compliance with the FCC's Computer III Open Network Architecture (ONA) requirements, and strengthened some of the nonstructural safeguards. In the interim, the Company had filed an interstate tariff implementing the ONA requirements. That tariff became effective on February 2, 1992, subject to further investigation. On March 9, 1992, the Company certified to the FCC that it had complied with all initial ONA obligations and should be granted structural relief for enhanced services. The FCC is expected to rule on that certification after mid-April 1992.

The FCC's December 1991 order has been appealed to various United States Courts of Appeals by several parties. Pending decisions on those appeals, which are not expected to occur before 1993, the FCC's decision remains in effect. If a Court again reverses the FCC, the Company's right to offer enhanced services could be impaired.

### FCC Cost Allocation Rules

In 1987, the FCC adopted rules governing (1) the allocation of costs between regulated and non-regulated activities, and (2) transactions with affiliates. Pursuant to those rules, the Company has filed a cost allocation manual which has been approved by the FCC.

The cost allocation rules apply to activities that have never been regulated as communications common carrier offerings and to activities that have been preemptively deregulated by the FCC. The costs of these activities are removed prior to the separations process and are allocated to non-regulated activities in the aggregate, not to specific services for pricing purposes. Other activities must be accounted for as regulated activities, and their costs will be subject to separations. These include (1) activities which have been deregulated by the FCC, without, pre-empting State regulation, (2) activities which have been deregulated by a state but not the FCC and (3) "incidental activities," which cannot, in the aggregate, produce more than 1% of a company's revenues.

The affiliate transaction rules generally require that assets be transferred between affiliates at market price, if such price can be established through a tariff or a prevailing price charged to third parties. In the absence of such information, transfers from a regulated to an unregulated affiliate must be valued at the higher of cost or fair market value, and transfers from an unregulated to a regulated affiliate must be valued at the lower of cost or fair market value. Services provided to an affiliate must be valued at tariff rates, or market prices if the service is also provided to unaffiliated entities. If the affiliate does not also provide the service to unaffiliated entities, the price must be determined in accordance with the FCC's cost allocation principles.

The FCC has not made its rules preemptive. State regulatory authorities are free to use different cost allocation methods and affiliate transaction rules for intrastate ratemaking, and to require carriers to keep separate allocation records.

#### Telephone Company/Cable Television Cross-Ownership

In 1987, the FCC initiated an inquiry into whether developments in the cable and telephone industries warranted changes in the "cross-ownership" rules prohibiting telephone companies such as the company from providing cable service in their service territories directly or indirectly through an affiliate.

On November 22, 1991, the FCC released a Further Notice of Proposed Rulemaking (FNPRM) in its cross-ownership proceedings. The FNPRM proposes to permit telephone companies such as the Company to provide video dial tone service on a common carrier basis.

The FCC also released a First Report and Order (Order) and a Second Further Notice of Inquiry (FNOI). In the Order, the FCC ruled that neither telephone companies that provide video dial tone service, nor video programmers that use these services, are required to obtain local cable franchises. The FNOI asks for comments on whether the FCC should recommend to Congress any changes in the statute prohibiting telephone companies from providing cable service in their telephone service areas.

### Interconnection and Collocation

On June 6, 1991, the FCC released a Notice of Proposed Rulemaking (NPRM) which proposes to allow third parties to collocate their equipment in, or very near, telephone company offices to provide special access (private line) services to the public. The FCC's stated purpose for the proposed rulemaking is to encourage greater competition in the provision of interstate special access services. The FCC has tentatively concluded that collocating parties would pay the telephone company an interconnection charge that is lower than the existing tariffed rates for similar non-located services. In the same release, the FCC issued a Notice of Inquiry (NOI) asking what policies it should adopt in regard to interstate switched access collocation. Comments and replies to the NPRM and NOI have been filed by the Bell Atlantic telephone companies and others. The FCC has not reached a final decision in either part of the proceeding, nor can the Company predict when such a decision will be made.

If the FCC permits increased competition by allowing collocation, the Company's revenues would be adversely affected, although some of the lost revenues could be offset by increased demand if, as the Bell Atlantic telephone companies requested in their comments, the FCC provides the Company with greater pricing flexibility. Collocation for the provision of switched access services would result in greater revenue losses to the Company than would special access collocation. The Company will not be able to estimate the revenue impact of either type of collocation until the conditions of collocation (if any) are determined and announced by the FCC.

### Intelligent Networks

On December 6, 1991, the FCC issued a NOI into the plans of exchange carriers, including the Company, to deploy new "modular" network architectures, such as Advanced Intelligent Network (AIN) technology. The NOI asks what, if any, regulatory action the FCC should take to assure that such architectures are deployed in a manner that is "open, responsive, and procompetitive". The FCC is still accepting comments on this NOI, and the Company cannot predict when the FCC will issue an order in this proceeding.

The results of this inquiry could include a requirement that the Company offer individual components of its services, such as switching and transport, to competitors who will provide the remainder of such services through their own facilities. Such increased competition could divert revenues from the Company. However, deployment of AIN technology may also enable the Company to respond more quickly and effectively to customer requests for new services. This could result in increased revenues from new services that could at least partially offset the expected competitive losses.

## STATE REGULATION AND INTRASTATE RATES

The communications services of the Company are subject to regulation by the District of Columbia Public Service Commission (PSC) with respect to intrastate rates and services, intrastate depreciation rates and other matters.

In June 1990, the PSC instituted a rate proceeding for purposes of investigating the earnings levels of the Company. Hearings were held in October 1991. In January 1992, the PSC issued its order, and on March 6, 1992 issued an order on reconsideration. The PSC reduced the Company's authorized return on equity to 12.5%, but found that the Company was entitled to increased revenues of \$632,000. The PSC adopted a one-year \$1.00 promotional rate for telephone service for low-income heads of households to increase telephone penetration in the District of Columbia. The PSC approved the Company's investment in fiber optics and other network modernization, virtually all of the Company's centralized services expenses, and a number of rate structure changes proposed by the Company.

In July 1988, the Company presented a proposal for flexible regulation to a working group established by the PSC to examine issues relating to restructuring the regulation of the Company. On December 30, 1988, the working group issued a report which rejected some of the Company's proposals and recommended that regulatory alternatives be considered in the context of a proceeding. In October 1989, the PSC held hearings on the issue of the criteria that should be used to determine the existence of competition. In June 1990, the PSC issued an order adopting criteria for determining whether actual or anticipated competition exists. In addition, the PSC established a working group to develop cost and demand study methodologies and other information necessary for application of the criteria. The working group submitted its final report in July 1991, which was approved by the PSC. In January 1992, the PSC issued an order setting procedures for processing applications by the Company for flexible regulation of particular services.

## NEW PRODUCTS AND SERVICES

### Bell Atlantic<sup>R</sup> IQ<sup>SM</sup> Services

The Company has introduced the Bell Atlantic IQ<sup>SM</sup> Services family of calling features. These features include Ident-a-Ring<sup>SM</sup>, which allows a single line to have multiple telephone numbers, each with a distinctive ring; Caller ID, which displays the number of the calling party; Repeat Call, which allows customers automatically to redial busy phone number; and Return Call, which allows customers automatically to return the last incoming call, even without knowing the number.

Other new services being offered or tested by the Company include Ultra Forward<sup>SM</sup> which customers can use to program call-forwarding instructions, and Home Intercom, which allows for phone-to-phone dialing within the home.

### Gateway Services

The Company is continuing its service trials for Gateway Services, which provide a single point of entry for users of personal computers to gain access to multiple databases.

### Information Services

The Company offers various types of information services, such as message storage services, voice mail electronic mail, and electronic data interchange (see "Line of Business Restrictions"). The Company also offers Answer Call, a telephone answering service aimed at residential and small business customers.

### COMPETITION

Regulatory proceedings, as well as new technology, are continuing to expand the types of available communications services and equipment and the number of competitors offering such services. An increasing amount of this competition is from large companies which have substantial capital, technological and marketing resources.

### Bypass

A substantial portion of the Company's revenues from business and government customers is derived from a relatively small number of large, multiple-line subscribers. In particular, the Federal government, its agencies and other constituent entities, provided 12% of the total revenues of the Company in 1991.

The Company faces competition from alternative communications systems, constructed by large end users or by interexchange carriers, which are capable of originating and/or terminating calls without the use of the local telephone company's plant.

Other potential sources of competition are cable television systems, shared tenant services and other non-carrier systems which are capable of bypassing the Company's local plant either completely, or partially, through substitution of special access for switched access or through concentration of telecommunications traffic on fewer of the Company's lines. In the Washington, D.C. metropolitan area, the Institutional Communications Company, in which Metropolitan Fiber Systems has acquired a controlling interest, has deployed an optical fiber network to compete with the Company in the provision of switched and special access services and local services.

Metropolitan Fiber Systems has filed petitions with the FCC and the Department of Justice seeking to require additional forms of interconnection with telephone company facilities to enhance their competitive efforts.

The Company seeks to meet such bypass competition by maintaining competitive cost-based prices for exchange access (to the extent the FCC and state regulatory authorities permit the Company's prices to move toward costs), by keeping service quality high and by effectively implementing advances in technology. (See "FCC Regulation and Interstate Rates - Interstate Access Charges", and "FCC Access Charge Pooling Arrangements.")

### Personal Communication Services

Radio-based personal communications services also constitute potential sources of competition to the Company. The FCC has authorized trials of such services, using a variety of technologies, by numerous companies. On January 16, 1992, the FCC adopted a Notice of Proposed Rulemaking to allocate a portion of the radio spectrum to emerging telecommunications technologies, including Personal Communications Service (PCS). PCS consists of a series of wireless portable telephone services which would allow customers to make and receive calls from any location using small handsets. If implemented, PCS and other similar services would compete with services currently offered by the Company, and could result in losses of revenues to the Company, although the Company may be able to derive new revenues if it obtains authorization to provide PCS or similar new services. If PCS is implemented, the FCC is expected to authorize more than a single service provider in each geographic area.

### Centrex

The Company offers Centrex service, which is a central office-based communications system for business, government and other institutional customers consisting of a variety of integrated software-based features located in a centralized switch or switches and extended to the customer's premises primarily via local distribution facilities. In the provision of Centrex, the Company encounters increasing competition from the providers of CPE systems, such as private branch exchanges (PBXs), which perform similar functions with less use of the Company's switching facilities.

Users of Centrex systems generally require more subscriber lines than users of PBX systems of similar capacity. The FCC increased the maximum Subscriber Line Charge on embedded Centrex lines to \$6.00 effective April 1, 1989. Increases in Subscriber Line Charges result in Centrex users incurring higher charges than users of comparable PBX systems. The PSC has approved Centrex tariff revisions designed to offset the effects of such higher Subscriber Line Charges.

The Company has reduced its Subscriber Line Charge for all customers, including Centrex customers, from \$4.08 per line in January 1989 to \$2.49 effective July 1, 1991.

### Directory

The Company's directory operations continue to face significant competition from other providers of directories as well as competition from other advertising media. In particular, the former sales representative of several of Bell Atlantic's telephone subsidiaries publishes directories competitive with those published by the Company.

### Coin Telephone Service

The Company faces increasing competition in the provision of coin telephone services.

### Operator Services

Alternative operator services providers have entered into competition with the Company's operator services product line.

### CERTAIN CONTRACTS AND RELATIONSHIPS

The Company is a party to various arrangements for provisions to the Company of management advice and assistance and of technical research and development.

Certain planning, marketing, procurement, financial, legal, accounting, technical support and other management services are provided for the Company on a centralized basis through Bell Atlantic Network Services, Inc. (NSI), a service subsidiary of Bell Atlantic. Bell Atlantic Network Funding Corporation provides financing services to the Company. Prior to 1990 the Company shared the expenses of joint officers and employees with the Chesapeake and Potomac Telephone Company of Maryland, the Chesapeake and Potomac Telephone Company of Virginia and the Chesapeake and Potomac Telephone Company of West Virginia, also wholly-owned subsidiaries of Bell Atlantic.

The seven RHCs each own (directly or through subsidiaries) a one-seventh interest in Bell Communications Research, Inc. (Bellcore). Pursuant to the Plan, this organization furnishes the RHCs and their BOC subsidiaries with technical assistance such as network planning, engineering and software development, as well as various other consulting services that can be provided more effectively on a centralized basis. Bellcore is the central point of contact for coordinating the efforts of the RHCs in meeting the national security and emergency preparedness requirements of the Federal government. It also helps to mobilize the combined resources of the companies in times of natural disasters.

### EMPLOYEE RELATIONS

As of December 31, 1991, the Company employed approximately 3,200 persons, representing a 5.9% decrease from the number of employees at December 31, 1990. Approximately one-fifth of these employees are members of the centralized staff of NSI, performing services for the Company on a contract basis. Approximately 77% of the employees of the Company are represented by the Communications Workers of America, which is affiliated with the AFL-CIO.

Under the terms of the three-year contracts ratified in September 1989 by unions representing associate employees, associates received a base wage increase of 2.25% and a cost of living increase of 1.15% in August 1991. Under the same contracts, associates have received a Corporate Profit Sharing payment of \$480 per person in 1992 based upon the Company's 1991 financial performance.

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Item 2. Properties

The principal properties of the Company do not lend themselves to simple description by character and location. At December 31, 1991, the Company's investment in plant, property and equipment consisted of the following:

Central office equipment	39%
Connecting lines	28%
Land and buildings	11%
Telephone instruments and related equipment	4%
Other	<u>18%</u>
	<u>100%</u>

"Central office equipment" consists of switching equipment, transmission equipment and related facilities. "Connecting lines" consists primarily of aerial cable, underground cable, poles, conduit and wiring. "Land and buildings" consists of land owned in fee and improvements thereto, principally central office buildings. "Telephone instruments and related equipment" consists primarily of public telephone instruments. "Other" property consists primarily of furniture, computers and office equipment, vehicles and other work equipment, capital leases, leasehold improvements and plant under construction.

The Company's central offices are served by various types of switching equipment. At December 31, 1991 and 1990, all of the local exchanges were served by electronic switching equipment.

An analysis of the estimated components of the Company's construction program for the last two years is as follows:

	(In Thousands)	
	<u>1991</u>	<u>1990</u>
Network modernization	\$ 34,120	\$ 15,970
Network support	23,240	54,910
Network growth	19,500	29,950
Operations Support	15,330	6,990
Market specific	10,780	8,990
Network replacement	<u>5,730</u>	<u>5,990</u>
	108,700	122,800
Allowance for funds used during construction	<u>220</u>	<u>460</u>
Total construction program	<u>\$108,920</u>	<u>\$123,260</u>

Item 3. Legal Proceedings

Pre-Divestiture Contingent Liabilities

The Plan provides for the recognition and payment by AT&T and the former BOCs (including the Company) of liabilities that are attributable to pre-Divestiture events but do not become certain until after Divestiture. These contingent liabilities relate principally to litigation and other claims with respect to the former Bell System's rates, taxes, contracts and torts (including business torts, such as alleged violations of the antitrust laws). Except to the extent that

affected parties otherwise agree, contingent liabilities that are attributable to pre-Divestiture events are shared by AT&T and the BOCs in accordance with formulas prescribed by the Plan, whether or not an entity was a party to the proceeding and regardless of whether an entity was dismissed from the proceeding by virtue of settlement or otherwise. Each company's allocable share of liability under these formulas depends on several factors, including the type of contingent liability involved and each company's relative net investment as of the effective date of Divestiture. Under the formula generally applicable to most of the categories of these contingent liabilities, the Company's aggregate allocable share of liability is approximately 0.5%.

The Company's share of these liabilities to date has not been material to its financial position or results of operations for any period. While complete assurance cannot be given as to the outcome of any contingent liabilities, in the opinion of the Company's management, any monetary liability or financial impact to which the Company is subject as a result of these contingent liabilities is not expected to be material in amount to the financial position of the Company.

#### Pending Cases

AT&T and various of its subsidiaries and the BOCs (including in some cases the Company) have been parties to various types of litigation, including litigation involving allegations of violations of antitrust laws and equal employment laws. Most of the litigation alleging violations of the antitrust laws has been resolved. However, other matters are still pending. Damages, if any, ultimately awarded in these remaining actions relating to pre-Divestiture events could have a financial impact on the Company whether or not the Company is a defendant since such damages will be treated as contingent liabilities and allocated in accordance with the allocation rules established by the Plan (see "Pre-Divestiture Contingent Liabilities" above).

While complete assurance cannot be given as to the outcome of any litigation, in the opinion of the Company's management, any monetary liability or financial impact to which the Company would be subject after final adjudication of all of the foregoing actions would not be material in amount to the financial position of the Company.

- Item 4. Submission of Matters to a Vote of Security Holders (omitted pursuant to General Instruction J(2)).

#### Part II

- Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters (inapplicable).
- Item 6. Selected Financial Data (omitted pursuant to General Instruction J(2)).
- Item 7. Management's Discussion and Analysis of Results of Operations (abbreviated pursuant to General Instruction J (2)).

This discussion should be read in conjunction with the Financial Statements and Notes to Financial Statements included in the Index set forth on page F-1.

The Company incurred a net loss of \$33,113,000 for the year ended December 31, 1991 due principally to the Company's election to adopt Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (Statement No. 106). In conjunction with this adoption, the Company recorded a one-time, non-cash, after-tax charge of \$79,725,000, representing the actuarial liability for postretirement health and life insurance benefits attributable to prior service of retired and active employees. The Company's rates of return to average common equity were (2.8)% and 14.3% for the years ended December 31, 1991 and 1990, respectively. The Company's rates of return on average total capital for the year ended December 31, 1991 and 1990 were (3.5)% and 11.2%, respectively. The decrease in these rates of return also resulted from the adoption of Statement No. 106. Net income, excluding the cumulative effect of the change in accounting principle decreased 6.6% over 1990.

Operating Revenues for the year ended December 31, 1991 increased \$7,575,000 or 1.4% over the same period last year. The increase in operating revenues is comprised of the following:

	<u>Increase/(Decrease</u> <u>(In Thousands)</u>
Local service .....	\$6,450
Network access .....	(1,409)
Toll service .....	1,264
Other .....	4,031
- Provision for uncollectibles.....	<u>(2,761)</u>
	<u>\$7,575</u>

Local service revenues are earned from the provision of local exchange, local private line and public telephone services. The increase in local service revenues is partially due to growth in revenues from mobile and private line services. These increases were partly offset by decreases due to a reduction of 1,746 in the number of access lines in service, as a result of continuing weakness in the economy. In addition, revenues from central office based services have decreased because the Company has negotiated long-term contracts at reduced rates with certain major customers.

The District of Columbia Public Service Commission (PSC) issued its final Order on March 6, 1992 (Order No. 9983) on the Company's requested \$39,000,000 rate increase in Formal Case No. 850. The Commission allowed a \$632,000 revenue increase to be effective March 14, 1992, and found a fair overall rate of return to be 10.34% based on a 12.5% return on equity.

Network access revenues are earned from interexchange carriers (IXCs) for the use of the Company's local exchange facilities in providing interstate and intrastate long-distance services to their customers, and from end-user subscribers. Switched access revenues are derived from usage based charges paid by IXCs for access to the Company's network. Special access revenues arise from access charges paid by subscribers who have private lines and end-user revenues are earned from local exchange carrier (LEC) customers who pay a flat monthly charge, per access line, for access to the network.

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Effective January 1, 1991, the Federal Communications Commission (FCC) adopted price cap regulation and lowered the authorized rate of return for interstate access services from 12.0% to 11.25%. Price caps, a form of incentive regulation, limit prices rather than profits. The FCC's price cap plan includes a sharing provision whereby interstate earnings above certain thresholds are shared equally with customers, while earnings above substantially higher thresholds are returned entirely to customers. Sharing occurs in the form of temporary prospective rate decreases. The Company reduced its rates for interstate access services on January 1, 1991 to reflect the lower authorized rate of return. In its first Annual Price Cap Tariff filing, effective July 1, 1991, the Company further reduced its rates. These two rate reductions, net of a lower obligation to the National Exchange Carrier Association pool, reduced 1991 revenues approximately \$2,600,000.

The decrease in network access revenues was substantially due to the aforementioned rate reductions, effective January 1, 1991. Lower demand for special access services also contributed to the decrease. These decreases were partially offset by a volume increase in access minutes of use from 2,424,000 in 1990 to 2,470,000 in 1991.

The increase in toll service revenues was substantially a result of an FCC-approved interstate revenue sharing arrangement which is designed to achieve a uniform rate of return among affiliated companies.

Other operating revenues include amounts earned from directory advertising, rent, billing and collection services provided to IXCs and premises services, such as inside wire installation and maintenance. Increases in other operating revenues include higher rent revenues of \$4,658,000 from affiliated companies for the use of Company facilities and increased commissions of \$3,442,000 under joint marketing agreements with affiliated companies. These increases were partially offset by decreases in billing and collection revenues of \$2,067,000 due to a decrease in the rates charged and the range of services provided to certain IXC's under the long-term contracts negotiated in 1990. Directory advertising revenues decreased \$704,000, because advertising volumes have been adversely impacted by the weak economy.

Operating revenues were further reduced by an increase of \$2,761,000 in the estimated provision for uncollectibles driven by weakened economic conditions.

Operating Expenses for the year ended December 31, 1991 increased \$13,584,000 or 3.1% from the same period in 1990. The increase in operating expenses is comprised of the following:

	<u>Increase/(Decrease)</u> (In Thousands)
Employee costs.....	\$ 5,991
Depreciation and amortization..	4,343
Taxes other than income.....	5,298
Other .....	<u>(2,048)</u>
	<u>\$13,584</u>

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Employee costs include salaries, wages, commissions, pension and benefit expenses and payroll taxes for employees paid directly by the Company. Similar costs incurred by employees of Bell Atlantic Network Services, Inc. (NSI) are allocated to the Company and are included in other operating expenses. Prior to 1991, the Company paid the Chesapeake and Potomac Telephone Company of Maryland, the Chesapeake and Potomac Telephone Company of Virginia, and The Chesapeake and Potomac Telephone Company of West Virginia (also wholly-owned subsidiaries of Bell Atlantic) for its share of the joint Directory Assistance (D.A.) Operator expenses. As such, the Company regarded these expenses as other operating expenses. In 1991, the Company began paying its proportionate share of D.A. Operators directly, and began accounting for the expenses as salaries and wages. This change increased salaries and wages expense approximately \$5,200,000. Salary increases for management employees and wage increases for associate employees as provided for in labor contracts also served to increase employee costs in 1991. Benefit costs increased 27.4% primarily due to increases in the costs of providing health care benefits to active and retired employees. The Company continued to address the adverse effects of health care inflation by implementing certain medical cost containment initiatives in 1991 that were included in the aforementioned labor contracts. Additional cost sharing arrangements affecting post January 1, 1992 management employees retiring after December 31, 1991 were also announced during 1991 in an effort to control future health care cost increases. Employee costs also included costs of \$351,000 associated with the retirement incentive program discussed below.

During the third quarter of 1991, the Company announced a retirement incentive program. Under the program, which expired November 15, 1991, 80 retirement-eligible management employees retired on December 15, 1991. (See Note 4 of Notes to Financial Statements.)

Depreciation and amortization expense increased \$4,343,000 compared to the same period in 1990 as a result of a 1.7% growth in depreciable plant.

Taxes other than income increased \$5,298,000 or 16.7% primarily as a result of the D.C. Public Utilities Gross Receipts Tax Amendment (the Amendment), effective July 1, 1991. The Amendment increased the gross receipts tax rate from 6.7% to 9.7%.

Other operating expenses consist primarily of network maintenance, rents, other general and administrative expenses and contracted services, including centralized expenses allocated from NSI. Other operating expenses for the year ended December 31, 1991 decreased 1.2%. As discussed above, the Company classified its share of joint D.A. Operator expenses as other operating expenses prior to 1991. This reclassification reduced other operating expenses approximately \$5,200,000. In addition, there were decreases of \$2,086,000 for product advertising. Other operating expenses in 1991 include \$2,700,000 of restructure related costs associated with the retirement incentive program and \$2,680,000 of additional costs allocated to the Company by NSI, as a result of its adoption of Statement No. 106. Cost containment policies implemented by the Company in 1991 have also served to decrease other operating expenses from the same period in 1990. Increased customer billing expenses from higher postal rates have also served to offset the above mentioned decreases.

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Interest Expense increased \$339,000 or 1.6% due to higher levels of short-term debt.

Operating Income Taxes decreased \$3,082,000 or 10.5% due principally to lower pre-tax income resulting from the aforementioned increased expenses. The effective income tax rate before the cumulative effect of a change in accounting principle was 35.7% compared to 36.7% for the same period in 1990. A reconciliation of the Statutory federal income tax rate to the effective rates is included in Note 6 of Notes to Financial Statements. A discussion of the prospective impact of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," is also included in that note.

Federal Regulatory Development - In June 1991, the FCC released a Notice of Proposed Rulemaking (NPRM) that proposes to allow third parties to collocate their equipment in, or very near, telephone company offices to provide special access (private line) services to the public. The FCC's stated purpose for the proposed rulemaking is to encourage greater competition in the provision of interstate special access services. The FCC has tentatively concluded that collocating parties would pay the telephone company an interconnection charge that is lower than the existing tariffed rates for similar non-located services. In the same release, the FCC issued a Notice of Inquiry (NOI) asking what policies it should adopt in regard to interstate switched access collocation. Comments and replies to the NPRM and NOI have been filed by Bell Atlantic and others. The FCC has not reached a final decision in either part of the proceeding, nor can the Company predict when such a decision will be made.

If the FCC permits increased competition by allowing collocation, the revenues of the Company would be adversely affected, although some of the lost revenues could be offset by increased demand if, as the local exchange carriers requested in their comments, the FCC provides them with greater pricing flexibility. Collocation for the provision of switched access services would result in greater revenues losses to the Company than would special access collocation. The Company will not be able to estimate the revenue impact of either type of collocation until the conditions of collocation (if any) are determined and announced by the FCC.

Financial Condition - During 1991, the Company generated \$127,668,000 in cash from operating activities, net of dividends, compared to \$155,019,000 in 1990. In 1991, the Company invested \$109,495,000 (net of reused materials and allowance for funds used during construction) in continued expansion and technological improvements to the network, compared to \$130,138,000 in 1990. Management estimates that 1992 gross capital expenditures will approximate \$ \$104,000,000. As of December 31, 1991, the Company's debt ratio was 48.6% compared to 40.8% at December 31, 1990. The debt ratio in 1991 was significantly impacted by the equity reduction associated with the adoption of Statement No. 106. Excluding this effect, the 1991 debt ratio would have been 39.8%.

Management believes that working capital and available credit facilities are adequate to meet normal operating requirements and that while presently foreseeable capital requirements will continue to be financed primarily through internally generated funds, some additional debt financing may be needed to maintain the Company's capital structure within management's guidelines.

Item 8. Financial Statements and Supplementary Data.

The information required by this item is set forth on pages F-1 through F-28.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of the Registrant (Omitted pursuant to General Instruction J(2)).

Item 11. Executive Compensation (omitted pursuant to General Instruction J(2)).

Item 12. Security Ownership of Certain Beneficial Owners and Management (omitted pursuant to General Instruction J(2)).

Item 13. Certain Relationships and Related Transactions (omitted pursuant to General Instruction J(2)).

PART IV

Item 14. Exhibits, Financial Statements, Financial Statement Schedules and Reports on Form 8-K.

(a) Documents filed as a part of the report:

(1) Financial Statements

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1.

(2) Financial Statement Schedules

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1.

(3) Exhibits

Exhibits identified in parentheses below, on file with the Securities and Exchange Commission, are incorporated herein by reference as exhibits hereto.

Exhibit Number (Referenced to item 601 of Regulation S-K)

- 3a Restated Certificate of Incorporation of the registrant, as amended September 14, 1990. (Exhibit 3a to Form 10-K for 1990, File No. 1-7368.)
  - 3b By-Laws of the registrant, as amended January 1, 1990. (Exhibit 3b to Form 10-K for 1989, File No. 1-7368.)
  - 4 No instrument which defines the rights of holders of long and intermediate term debt of the registrant is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, the registrant hereby agrees to furnish a copy of any such instrument to the SEC upon request.
  - 10a Agreement Concerning Contingent Liabilities, Tax Matters and Termination of Certain Agreements among AT&T, Bell Atlantic, the Bell Atlantic telephone subsidiaries, and certain other parties, dated as of November 1, 1983. (Exhibit 10h to Bell Atlantic Corporation Annual Report on Form 10-K for the year ended December 31, 1983, referred to hereafter as "Bell Atlantic 1983 Form 10-K.")
  - 10b Agreement among Bell Atlantic Network Services, Inc. and the telephone subsidiaries, dated November 7, 1983. (Exhibit 10i to Bell Atlantic 1983 Form 10-K.)
  - 25 Powers of Attorney.
- (b) Reports on Form 8-K:
- No Form 8-K was filed by the registrant during the quarter ended December 31, 1991.